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IN THE

# Supreme Court of the United States

OCTOBER TERM—1964

No. 333

ELAINE YAGODA (Formerly Elaine Drechsler) *et al.*,
*Petitioners,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.**

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IN THE

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ELAINE YAGODA
(Formerly Elaine Drechsler) *et al.*,
*Petitioners,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

Petitioners petition for a writ of certiorari to review the judgment of the Court of Appeals for the Second Circuit. The petitioners are: 1) Elaine Yagoda (formerly Elaine Drechsler), 2) Trust For the Benefit of Lena Drechsler, Lena Drechsler, Exec. of Estate of Gus Drechsler, Deceased Trustee, 3) Trust For The Benefit of Elaine Drechsler, Lena Drechsler, Trustee, and [redacted] Lena Drechsler.

## Opinion Below

The opinion of the Court below is reported at 331 F. 2d 485 and appears at p. 4a of appendix, *infra.*

## Jurisdiction

The determination of the Tax Court of the United States as reported in 39 T. C. 170 (App. 18a)* was affirmed by the Court of Appeals for the Second Circuit on May 1,

*App. references are to printed appendix to appellant's brief in the Court of Appeals, nine copies of which have been filed with this Court.

1964. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

## Questions Presented

1. Can the Commissioner of Internal Revenue be allowed to assess and collect a time-barred deficiency under Sections 1311-1314 of the Internal Revenue Code of 1954 when petitioners and any related taxpayer have never taken an erroneous or inconsistent position or any position to the detriment of the Commissioner?

The Courts below held that he can. The Ninth Circuit in *Commissioner v. Estate of Weinreich*, 316 F. 2d 97 (1963), held and the statutory language, legislative history and the Commissioner's regulations say he cannot.

2. In order to extend the period of limitations in which the Commissioner of Internal Revenue can assess and collect a tax under Section 1311 of the Internal Revenue Code of 1954, the "inconsistent position" statute, must the inconsistent position

(1) be taken by the taxpayer or a related taxpayer, and

(2) be inconsistent with a position taken earlier by the taxpayer or a related taxpayer on his original return?

The Courts below held that these statutory conditions need not be satisfied. The Ninth Circuit in *Estate of Weinrich, supra,* held and the Treasury Regulations state they must be satisfied.

3. In order to extend the period of limitations in which the Commissioner of Internal Revenue can assess and collect a tax under Section 1311 of the Internal Revenue Code of 1954, must the inconsistent position be taken by the tax-

payer or a related taxpayer after the statute of limitations has run or be about to run on the year of the first position?

The legislative history and applicable Treasury Regulations affirmatively indicate that such circumstance must exist to lift the bar of the statute of limitations. The Courts below held to the contrary.

4. Assuming that there was an inconsistent position taken by the taxpayer or a related taxpayer at the time the related taxpayer filed claims for refund on August 9, 1949, was there in existence the relationship required under Section 1311(b)(3) of the Internal Revenue Code of 1954 at the time of the filing of the refund claims as aforesaid to permit an adjustment thereunder?

## Statutes Involved

Pertinent provisions of the Internal Revenue Codes of 1939 and 1954 are all set forth in the Appendix, *infra*, pages 1a through 3a.

## Statement

### A. The Proceedings Below

The petitioners and a related party, Gus Drechsler, properly reported their distributable share of partnership income in their respective tax returns for 1944 and 1945. The Commissioner of Internal Revenue over objections of all parties, refused to recognize the petitioners as partners and asserted deficiencies in tax against Gus, offset by proposed overassessments against the trusts and Lena. The petitioners neither agreed to the proposed overassessments nor consented to the application of the proposed overassessments to the deficiencies due from Gus Drechsler (deceased January 12, 1946). The net deficiency was paid by the

estate of Gus Drechsler in November 1948. In August 1949 claims for refund were filed by the estate of Gus Drechsler. At this time the Commissioner had more than 18 months to move against the petitioners to correct the overassessments previously determined by him over the protest of the petitioners. In November 1949, counsel for estate of Gus Drechsler and petitioners directed the Commissioner's attention to the probable need of protecting his position with respect to the trusts and Lena.

Subsequently a decision of the United States District Court for the Southern District of New York determined that the trusts and Lena were valid partners and the returns as filed (subject to certain adjustments previously agreed to by the parties) were correct. Pursuant to the judgment of the District Court, the estate of Gus Drechsler received refunds for the years 1944 and 1945 on or about January 9, 1959. Statutory notices of deficiency were thereafter sent to the petitioners herein on June 5, 1959.

Petitions for redetermination of the proposed deficiencies were then filed in the Tax Court of the United States in behalf of petitioners, wherein amongst other things, petitioners contended that the Commissioner's notices of deficiency for 1944 and 1945 were barred by the statute of limitations and that the provisions of Sections 1311-1314 of the Internal Revenue Code of 1954 did not raise the bar of limitations to permit them to assess and collect the deficiency. The Commissioner successfully contended that the position maintained by Gus Drechsler that there existed a valid partnership between him and the petitioners as well as others was inconsistent with the erroneous exclusion of partnership income by the Commissioner from the gross income of the related taxpayers for each of the years 1944 and 1945, and that therefore the mitigating provisions of Sections 1311-1314 of the Internal Revenue Code of 1954 sanctioned his right to issue the notices of

deficiency. The Tax Court of the United States rendered its opinion upholding the Commissioner's contention.

With respect to the partnership at issue, the parties below had stipulated that by the end of March 1945 the partnership had substantially completed its operations, that the partnership terminated its business and existence on August 31, 1945, but thereafter such actions were taken as were necessary to wind up its affairs and make final distribution of its assets, and that a final partnership return of income was filed for the period January 1, 1945 through August 31, 1945. Also submitted by stipulation of the parties was the partnership agreement which provided that the partnership shall terminate upon the decease of any one of the partners, which condition occurred on January 12, 1946 when Gus Drechsler died.

**B. The Decision of the Court of Appeals**

The Court of Appeals in affirming the judgment of the Tax Court dealt with the questions presented as follows:

1. The Court of Appeals accepted the position of the Tax Court that Section 1311(b)(1) of the Internal Revenue Code of 1954 was satisfied when a final determination was made by the District Court which "[was] inconsistent with the erroneous exclusion . . . of the partnership income . . ." (pp. 489-90, p. 11a, *infra*), notwithstanding the fact that the inconsistency was brought about by the action of the Commissioner in erroneously disallowing the validity of the partnership in the first place.

In agreeing with the Tax Court, the Court below read the statute to be remedial, and that the statute of limitations should be lifted even though but for the error of the Commissioner in disallowing the validity of the partnership, litigation would have been unnecessary, which litigation ultimately sustained the validity of the partnership. In

reaching this conclusion the Court below further adopted the reasoning of the Tax Court and the Commissioner in holding that the maintaining of an inconsistent position by the taxpayer, a condition required under Section 1311 (b)(1), need only be an inconsistency with the exclusion of the partnership income and not an inconsistency in position taken by the taxpayer or related taxpayers themselves. This inconsistency, the Court below held was first maintained within the meaning of Section 1311(b)(1) by a related taxpayer (Gus Drechsler, then a partner of petitioners) when he and petitioners filed their individual income tax returns for 1944 and 1945 reflecting correct percentages of partnership income. Having so held, it followed, reasoned the Court, that Gus Drechsler and the petitioners had the necessary relationship (i.e. of partners) when the returns were filed for 1944 and 1945 under the requirement provided in 1311(b)(3) that before the adjustment can be made by the Commissioner (lifting the bar of the statute of limitations), the related taxpayer must stand in such relationship at the time he first maintained an inconsistent position.

The decision of the Court of Appeals in this proceeding is clearly erroneous in that it is contrary to the intent of Congress as expressed in the legislative history, as well as Commissioner's own regulations. Such intent must be given recognition in the construction of any statute, particularly when it has been delineated and clearly expressed.[1]

The intent of Congress has been expressed at length in the Senate Finance Committee Report[2] and by the House Managers[3] in reporting the conference agreement at the time of adoption of Section 820 of the Revenue Act of 1938,

[1] *Commissioner* v. *Bilder* 369 U. S. 499; *United States* v. *Pelzer* 312 U. S. 399; *United States* v. *American Trucking Association* 312 U. S. 534, 544.

[2] Senate Fin. Comm. Rep. No. 1567, 75th Cong., 3rd Sess.

[3] H. R. Rep. No. 2330, 75th Cong., 3rd Sess.

subsequently Section 3801 of Internal Revenue Code of 1939 and predecessor of Sections 1311-1315 of Internal Revenue Code of 1954.

In the Senate Finance Committee Report, the purpose and indicated scope of the new provisions were stated to be:

> "The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation by the beneficiary of the statutory bar, of opportunities *only open to him* if he assumes a position *diametrically opposed* to that taken *prior to the running of the statute.*" (emphasis supplied)

The House Managers stated:

> "This amendment provides for mitigation of some of the inequities under income tax laws caused by the statute of limitations and other provisions which now prevent equitable adjustment of various income tax hardships * * *. Under the income tax laws it is possible for a taxpayer or the Commissioner, *after* operation of the statute of limitations or some other provision of the Internal Revenue law prevents correction of an error, to obtain a double advantage by taking a position *contradictory* to that which caused the error. The Senate amendment was drawn to discourage *this* practice in specific types of cases by authorizing corrective adjustment." (emphasis added)

Is there any doubt from the foregoing statements that Congress was legislating to prevent 1) the *taking* of a new position after the statute of limitations or a closing agreemen prevented the correction of an error, 2) where the earlier position caused the error, and 3) the second position taken was contradictory to the earlier erroneous one?

The three illustrations given by the Senate Finance Committee which were referred to as the "specific types of

cases" by the House Managers, as well as the eleven illustrations given by the Bureau of Internal Revenue in T. D. 4856,[4] repeated in Reg. 118, Sect. 39.3801(b) and Reg. 1.1311 and 1.1312, promulgated under the Internal Revenue Code of 1954 show that the mitigating statutes were to be invoked only when the statute of limitations had already run or was just about to run when an inconsistent position was being first maintained. See *J. C. Bradford*, 34 T. C. 1051. To the same effect are erudite articles on the subject.[5]

In the instant case neither of the petitioners ever took a position inconsistent with each other, with the related taxpayer, Gus Drechsler, or with any of their previous actions. Their tax returns correctly reflected their proper percentages of partnership income.

At the time claims for refund were filed on behalf of Gus Drechsler to recover deficiencies erroneously asserted by the Commissioner, approximately 18 months remained in which the Commissioner could have acted to recover erroneous over-assessments resulting from the actions initiated by him over the protests of the petitioners and the related taxpayer, pursuant to Sect. 3746(b) of the Internal Revenue Code of 1939. In fact the Commissioner's attention was called to this possible course of action but he chose to do nothing (App. 25a; 331 F. 2d at 487, p. 7a *infra*).

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[4]Cum. Bull. 1938-2, pp. 115-119.
Article 820(b)1-Ex. 1, 2.
Article 820(b)2-Ex. 1, 2.
Article 820(b)5-Ex. 1(c), 3, 4.
Article 820 (b)7-Ex. (a)-1, (b)-1.

[5]Maguire, Surrey and Traynor, Yale Law Journal Feb. & Mar. 1939. (Maguire was Professor of Law, Harvard Law School; Surrey was Asst. Legislative Counsel, U. S. Treas. Dept.; Traynor was Professor of Law, University of Calif., School of Jurisprudence).
Arthur H. Kent, Calif. Law Rev. Vol. 27 No. 2.
J. H. Landman, 5 Tax Law Rev., New York University (1950—p. 547).
Aubrey Marrs, Head of Technical Staff, Bureau of Internal Revenue, speaking before Tax Clinic of American Bar Association, July 28, 1938 (Tax Mag. Nov. 1938 p. 665).

The actions of the petitioners did not constitute active exploitation by any petitioners of the statutory bar, ". . . of opportunities *only open to him* if he assumes a position diametrically opposed to that taken prior to the running of the statute",[6] as illustrated in Committee cases and those contained in the regulations.[7] Petitioners submit a first correct return cannot by its very nature be an inconsistency that is exploiting the statutory bar. There is, of course, no statutory bar at that time. There is no previous action with which it can be inconsistent. If it is inconsistent with later action, then it is the later action that is the first inconsistency (inconsistent with earlier action).

The Commissioner's difficulty in this case lies in the fact that there has been no inconsistency on the part of the petitioners. The error leading to a double exclusion of income has been of the Commissioner's own making, and he may not invoke Secs. 1311-14 to obtain a deficiency as a result of his own deliberate actions.

The Senate Finance Committee in adopting Section 820 of the Revenue Act of 1938 stated that its purpose was "to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials, and whether fortuitous or the result of design", that the legislation was to preserve the statute of limitations unimpaired and only be modified "when the party or parties in whose favor it applies shall have justified such

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[6] fn 2 *supra*.

[7] Particularly in point is the example listed under Reg. 1.1311(b)-1 (c)(2). In the instant case the correct treatment of partnership income in the returns filed by the petitioners and the related party was at odds with the erroneous treatment by the Commissioner in 1949, but said erroneous treatment was of the Commissioner's own doing and he may not use his own action as a basis for setting aside the bar of the statute of limitations. See *Estate of Goldstein*, T. C. M. 1963-258, Sept. 24, 1963.

modification by active inconsistency". This statement of purpose can only make sense if it is interpreted to mean inconsistency by the taxpayer with prior action of the taxpayer or related party, and inconsistency by the Commissioner with prior action of the Commissioner.[8]

The words "whether fortuitous or by design" do not destroy this requirement of *shift of position*. The shift of position might be deliberate and with tax malice or due to original oversight or possibly change in judicial interpretation in an intervening period. But there must be a shift in position by the party against whom the bar of the statute is sought to be lifted. *Cory* v. *Commissioner*, 261 F. 2d 702 (2nd Cir. 1958), *Olin Mathieson Chemical Corp.* v. *United States*, 265 F. 2d 293 (7th Cir. 1959), *United States* v. *Rachal*, 312 F. 2d 376 (5th Cir. 1962), are all distinguishable from the instant case on the facts. *Olin Mathieson Chemical Corp.* v. *United States*, *supra*, dealt with a section 1312(4) circumstance of adjustment for which no inconsistent position was required. In *Cory* v. *Commissioner*, supra, and *United States* v. *Rachal*, supra, there were shifts in position by the party against whom sections 1311-1314 were being invoked.

In a case involving similar facts, but in certain respects less favorable to the taxpayer there, the Court of Appeals for the Ninth Circuit in *Commissioner* v. *Estate of Weinreich*, *supra*, rejected the same arguments that the Commissioner has made in the instant case and held the inconsistent position required of the taxpayer was one inconsistent with a prior position of the related partner, and which had to

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[8]Merten's Law of Fed. Income Taxation Chap. 14, p. 57.
The Senate Finance Committee Report (Cum. Bull. 1939-1 part 2, p. 815).
Yale Law Journal Feb. 1939 p. 519; Mar. 1939, pp. 725, 735, 739, 755.
Cal. Law Review Vol. 27 No. 2, pp. 122, 140, 144.

relate to a position already in existence. In that case the filing of a claim for refund was deemed to be the initiating act inconsistent with the acceptance of the refund by the related party.

In the instant case neither of the petitioners consented to nor received the tax refunds resulting from the overassessment determined by the Commisisoner. The Commissioner without the consent of the petitioners credited the overassessment to the deficiency of a related taxpayer, Gus Drechsler.[9] Having previously paid the taxes on their partnership shares of income, the deficiency now asserted against the petitioners here, means in effect, the double taxation of the same income.

The parties stipulated "T. F. Jackson Company, partnership, *terminated its business and existence* on August 31, 1945 but thereafter such actions were taken as were necessary to wind up its affairs and make final distribution of its assets." (App. 21a) (emphasis supplied) It was also stipulated "By the end of March 1945, the partnership had substantially completed its operations on all of the tankers it had contracts to construct and there remained no additional work due to imminent cessation of hostilities." A final partnership return of income was filed for the period January 1, 1945 through August 31, 1945. (App. 21a)

If the petitioners are deemed to have taken inconsistent positions within the purview of the statutes, such act did not occur until claims for refund were filed in August 1949 on behalf of Gus Drechsler, deceased. At this time no vestige of the partnership relationship remained. Arguendo, even if the contention of the court below is sustained that

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[9]There isn't even that "inconsistency" which, if existing, would be after the partnership had terminated, whether the inconsistency dated from the allowance of the overassesment to petitioners or the filing of claims for refund by a related taxpayer.

the filing of correct original income tax return may be the taking of an inconsistent position, the partnership relationship no longer existed in 1946 when the tax returns for 1945 were filed.

The purpose of the requirement for the existence of a specific relationship when the "inconsistent position is first maintained" was to insure accountability between related parties—in this instance that of partners.[10]

Moreover, paragraph 18 of the partnership agreement provided, "In the case of the decease of any one of the partners, the partnership shall terminate, but the right is given to the surviving partner to purchase the share or interest in the partnership of the deceased partner * * *. When Gus Drechsler died on January 12, 1946 (App. 23a) all partnership activity had already terminated, a final partnership return of income for the period Jan. 1, 1945 through Aug. 31, 1945 had been filed, and payment for his interest had been made except for a nominal amount subsequently paid to his estate. There was no need to purchase Gus Drechsler's interest. After Gus Drechsler's death, his estate and Lena and the trust for Elaine were no longer partners responsible to and for each other.

The tenuous thread of awaiting a final nominal cash distribution from a non-related individual who was serving as trustee for the former partners, where all other partnership activity had ceased, does not constitute standing in the required chargeable partnership relationship. If one partner sells his interest in a partnership, thus ending a business association, but is not paid by the partnership until a later date, he is no longer a partner for tax purposes. *Ralph W. James*, T. C. M. 1962-173.

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[10]The Tax Court found: "The only relationship in question under the related taxpayer definition in Section 1313(c), is that of 'partner'.

**Reasons For Granting the Writ**

The decision of the Court below in the instant case is in direct conflict with a unanimous decision of the United States Court of Appeals for the Ninth Circuit in *Commissioner* v. *Estate of Weinreich, supra.* The Tax Court's decision in the instant case was bottomed on its decision in *Geraldine Snyder Weinreich*, 37 T. C. 365 which was subsequently reversed by the Ninth Circuit. The Second Circuit in its decision noted that *Weinreich* "involved a fact pattern substantially identical to that now before us" but rejected the view of the Ninth Circuit.

In both cases the returns of partners were correctly filed, the Commissioner initiated an erroneous overassessment to one partner and asserted a deficiency against another, and when claims for refund were filed after the deficiencies were paid, the partnership relationship was no longer in existence.

In rejecting the principles expressed by the Ninth Circuit in *Commissioner* v. *Estate of Weinreich, supra,* the Court below has in effect held that the Commissioner may with cupidity, make tax determinations of his own choosing and when proven wrong, then claim the benefits of Sections 1311-14 to set aside the bar of the statute of limitations. Such a decision left standing could only lead to a multiplicity of litigation with resulting administrative chaos since the Commissioner could not suffer from improper actions taken by him.

Clearly, the difference in legal principles derived from the same set of facts by two different United States Circuit Courts of Appeal requires this Court to grant certiorari to settle the question. The interpretation of Sections 1311-1314 and predecessor sections since their original adoption

as Section 820 of the Revenue Act of 1938 and then as Section 3801 of the Revenue Act of 1939, have continually plagued the Courts.[11] The nature of the statutes, their subject matter, and the prevalence of situations falling thereunder are such that a continuing flow of litigation can be anticipated until the legal principles applicable have been resolved by the Supreme Court. Most certainly, the question is of great importance in the administration of the Federal tax statutes, and attorneys are entitled to have the law settled to be able to properly advise their clients.

## CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

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[11]The list of litigation involving the construction of the mitigation of limitations statutes is long, encompassing over 80 cases in the Tax Court, 19 District Courts, the Court of Claims, and 9 Courts of Appeal. Numerous articles have appeared in law journals and professional magazines in the endeavor to interpret various aspects of the confusion inherent in the wording of the mitigation statutes.

## APPENDIX

### Statutes Involved

Internal Revenue Code of 1954.

Section 1311. Correction of Error.

(a) General Rule.—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) Conditions Necessary for Adjustment.—

(1) Maintenance of an Inconsistent Position.—Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be under this part only if—

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary or his delegate, or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made.

and the position maintained by the Secretary or his delegate in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be. * * *

(3) Existence of Relationship.—In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312(3)(B), the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court of the United States for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

Section 1312. Circumstances of Adjustment.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

* * * *

(3) Double Exclusion of an Item of Gross Income.—

(A) Items Included in Income—The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted

from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer. * * *

Section 1313. Definitions.

* * * * *

(c) Related Taxpayer.—For purposes of this part, the term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

* * * * *

(6) partner

Internal Revenue Code of 1939.

Section 3746. Suits For Recovery of Erroneous Refunds.

(b) Refunds Otherwise Erroneous.—Any portion of an internal revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be considered as erroneous under section 3774) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund.

# UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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Nos. 64-5-6-7—September Term, 1963.
(Argued January 22, 1964 Decided May 1, 1964.)
Docket Nos. 28244-5-6-7

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ELAINE YAGODA (formerly Elaine Drechsler),
*Petitioner,*

—v.—

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

---

Trust for the Benefit of LENA DRECHSLER, LENA DRECHSLER, Exec. of Estate of GUS DRECHSLER, Deceased Trustee,
*Petitioner,*

—v.—

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

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Trust for the Benefit of ELAINE DRECHSLER,
LENA DRECHSLER, Trustee,
*Petitioner,*

—v.—

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

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LENA DRECHSLER,
*Petitioner,*

—v.—

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

---

Before:

FRIENDLY and HAYS, *Circuit Judges*, and ANDERSON, *District Judge*.*

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Petition to review decisions of the Tax Court of the United States. 39 T. C. 170 (1962), determining deficiencies against petitioners under 26 U. S. C. §§ 1311-1314.

Affirmed.

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BERNARD WEISS, New York City, *for Petitioners*.

RICHARD J. HEIMAN, Department of Justice, Washington, D. C. (Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson, and David O. Walter, on the brief), *for the Commissioner*.

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HAYS, *Circuit Judge*:

Petitioners seek review of decisions of the Tax Court of the United States. 39 T. C. 170 (1962), holding (I) that the mitigation provisions of Sections 1311-1314 of the Internal Revenue Code of 1954 permit the assessment of certain deficiencies that would otherwise be barred by the statute of limitations, and (II) that petitioner Elaine Yagoda (formerly Elaine Drechsler) is liable as transferee of a trust for the benefit of Elaine Drechsler.

During the taxable years in question, 1944 and 1945, Gus Drechsler and petitioner Lena Drechsler were husband and wife. Gus Drechsler died on January 12, 1946 and

*Sitting by designation.

Lena as executrix filed Gus's income tax return for 1945. Petitioner Elaine Yagoda is the daughter of Gus and Lena Drechsler.

Gus Drechsler was one of three stockholders in T. Frederick Jackson, Inc., a corporation engaged in the business of electrical contracting. On October 26, 1944, the corporation assigned certain contracts to a partnership, T. F. Jackson Company, formed that day by Gus and the other two shareholders. Gus then created two irrevocable trusts, one for the benefit of Lena and one for the benefit of Elaine, and gave to each trust a 27% partnership interest, retaining a 6% interest in his own name. On April 9, 1945, Lena, by terminating the trust for her benefit in accordance with the provisions of the trust and receiving all the property of the trust, became a partner in her own right. The partnership terminated its business and existence on August 31, 1945, but thereafter such actions were taken as were necessary to wind up its affairs and make final distribution of its assets.[1] This litigation is occasioned by the attempt of the Commissioner to correct certain errors in the allocation of the income of the T. F. Jackson Company partnership.

On the partnership tax returns for 1944 and 1945, Gus, the trust for the benefit of Lena (in 1945, Lena), and the trust for the benefit of Elaine were shown as entitled to 6 percent, 27 percent and 27 percent, respectively, of the partnership's distributable net income. These proportionate shares of partnership income were reported in the respective 1944 and 1945 income tax returns for the trusts and the individual partners.

The income tax returns of the partnership, Gus, and the two trusts for 1944 and 1945 and the individual return of Lena for 1945 were examined as a unit by the Commissioner.

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[1]See footnote 5, *infra*.

The Commissioner refused to recognize either the two trusts or Lena, individually, as bona fide partners of T. F. Jackson Company during 1944 or 1945 and treated their respective shares of the partnership income as income to Gus. As a result, deficiencies of $47,927.11 and $42,258.90 were determined against the estate of Gus Drechsler for the years 1944 and 1945. These deficiencies were paid in full with interest on November 19, 1948, payment being effected in part by the Commissioner's crediting against the deficiencies overassessments with respect to the trusts and Lena Drechsler.

On August 9, 1949, Lena Drechsler, as executrix of the estate of Gus Drechsler, filed claims for refund of the deficiencies. During Internal Revenue Service consideration of the claims, the revenue agent assigned to the case was advised by counsel for the estate that the government should take the necessary steps to protect its position with regard to the trusts and Lena. The agent replied that it was not necessary to send out deficiency notices to these other taxpayers, since any refund to the estate could not exceed the cash payment made by the estate, exclusive of the overassessments credited to the trusts and Lena. The Commissioner disallowed the refund claims and the estate brought suit in the United States District Court for the Southern District of New York. On April 18, 1958, the district court rendered judgment, 161 F. Supp. 319 (1958), for the estate in the entire amount of the deficiencies, inclusive of the overassessments. That determination became final on September 19, 1958, when the notice of appeal filed by the United States was dismissed by stipulation. By that time correction of the effect of the error of excluding, through crediting the overassessments, any share of partnership income from the returns of the trusts and Lena would have been prevented, absent Sections 1311-1314, by operation of the statute of limitations. Proceeding under these mitigation of limitations provisions, the Commissioner

sent statutory notices of deficiency to the petitioners on June 5, 1959. Liability as partners is asserted against Lena (for 1945) and the trusts. Liability as transferees is asserted against Lena (for 1944) and Elaine.

I.

Prior to the Revenue Act of 1938 a double advantage could accrue to the Commissioner or to a taxpayer who successfully maintained as to the treatment of a particular item in an open year a position inconsistent with an erroneous treatment of the same item in another year that could not be reopened because of the statute of limitations or some other rule of finality. In some cases the courts mitigated the resulting inequities through the application of the doctrines of estoppel or recoupment, but such decisions were neither uniform nor systematic. See S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938), 1939-1 (Part 2) Cum. Bull. 779, 815 (1939). Section 820 of the 1938 Code which became Section 3801 of the 1939 Code and Sections 1311-1314 of the 1954 Code supplied more definitive guideposts for dealing with such situations. Sections 1311-1314 list certain "circumstances of adjustment," such as the double inclusion or exclusion of an item of gross income or the double allowance or disallowance of a deduction, and provide in general that for one year from the date of the final determination resulting in such a situation the closed year may be reopened as against the party who maintained the position adopted by the determination.

The parties are in agreement that this case satisfies the requirements set forth in section 1311(a), which states the general rule for the mitigation of the statute of limitations:

> "(a) General Rule.—If [1] a determination (as defined in section 1313) is [2] described in one or more of the paragraphs of section 1312 and, [3] on the

> date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law. . . . then [4] the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314."

(1) The decision of the district court sustaining the estate's claim for a refund became final on September 19, 1958, at which time it was a "determination" within the meaning of section 1313(a)(1):

> "(a) Determination.—For purposes of this part, the term 'determination' means—
>
> (1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final . . ."

(2) That determination presents the circumstance of adjustment described in section 1312(3)(A):

> "(3) Double exclusion of an item of gross income.—
>
> (A) Items included in income.—The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted . . . from the gross income of a related taxpayer . . ."

The determination requires the exclusion from Gus's gross income of 54% of the partnership income, on which Gus had previously paid tax and which was erroneously excluded from the gross income of Lena and the Lena and Elaine Trusts for 1944 and 1945.[2] In those taxable years

[2]Since taxpayers did not receive the direct benefit of the overassessments, they can be held liable for a deficiency only if they consented to the crediting of the overassessments against Gus's tax liability and were therefore contructively benefited. See *Murray* v.

the Elaine Trust and the Lena Trust or Lena were partners with Gus and were therefore related persons.[2] (3) On the date of the determination, correction of the erroneous exclusion was prevented by the statute of limitations. (4) The Commissioner has sought to correct the error by the assessment of a deficiency within one year of the date of the determination, as required by section 1314:

> "(b) Method of adjustment.—The adjustment authorized in section 1311(a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year or years . . ."

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*United States*, 292 F. 2d 602 (1st Cir. 1961), judgment on first remand rev'd, 300 F. 2d 803 (1962), judgment on second remand aff'd, 316 F. 2d 29 (1963). Taxpayers contend that the Commissioner failed to prove such consent. Although the burden of proof was on the government on this issue, *Murray v. United States, supra*, we think consent must be inferred because of the interrelationships of the parties in this case. At the time the overassessments were made and Gus's net deficiency was paid, Lena Drechsler was executor of Gus's estate, sole beneficiary of the trust for the benefit of Lena Drechsler, and sole trustee of the trust for the benefit of Elaine Drechsler. In her various capacities she acted for all the parties involved.

[3]Section 1313(c) provides:

> "For purposes of this part, the term 'related taxpayer' means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:
>
> * * *
>
> (6) partner . . ."

The present case clearly meets all these requirements. The only controversy is with respect to two of the "conditions necessary for adjustment" which are set forth in section 1311(b).

Taxpayers contend, first, that Gus did not maintain an inconsistent position within the meaning of section 1311 (b)(1):

> "(1) Maintenance of an inconsistent position. —Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if—
>
> * * * * *
>
> (B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made, and the position . . . maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be."

On its face, section 1311(b)(1) would seem to have been satisfied. The determination adopted the position maintained by Gus before the district court that the trusts and Lena were his partners and that their share of the partnership income should be excluded from his gross income, and that position was inconsistent with the erroneous exclusion of the allocable portions of the partnership income from the gross income of the trusts and Lena.

Taxpayers argue, however, that the legislative history of the Revenue Act of 1938 indicates that the predecessor of Sections 1311-1314 was intended only to prevent exploitation of the statute of limitations by "active incon-

sistency." They rely principally upon a statement in the Senate Finance Committee report that:

> "The purpose of the Statute of Limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running of the statute . . . The legislation here proposed is based upon the following principles: (1) to preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency . . ."

S. Rep. No. 1567, 75th Cong., 3d Sess. 49-50 (1938), 1939-1 (Part 2) Cum. Bull. 779, 815, (1939). See *Commissioner* v. *Estate of Weinreich*, 316 F. 2d 97, 105 (9th Cir. 1963). In the present case, the argument continues, the taxpayers have not actively sought to exploit the statute of limitations. The taxpayers note that the original returns of Gus and the other taxpayers were consistent with each other and correct and that the Commissioner was advised to protect the government's position against the trusts, Lena, and Elaine at the time the estate made its claim for a refund. But for the Commissioner's erroneous determination that the trusts were not bona fide partners and the subsequent failure to protect the government's position before the statute of limitations had run, the present litigation need never have arisen. Taxpayers conclude that it is inequitable to remove the statutory bar as against them, when the difficulty was created by the actions of the government.

Taxpayer's argument, however, misconceives the nature of the mitigation of limitation provisions, which are remedial, not punitive. *Cory* v. *Commissioner*, 261 F. 2d 702,

704 (2d Cir. 1958), cert. denied, 359 U. S. 966 (1959); *Olin Mathieson Chem. Corp.* v. *United States*, 265 F. 2d 293 (7th Cir. 1959). The Senate Finance Committee report cited by taxpayers itself declares that the mitigation provisions are intended "to take the profit out of inconsistency, whether exhibited by taxpayers or revenue agents, and *whether fortuitous or the result of design.*" S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938), 1939-1 (Part 2) Cum. Bull. 779, 815 (1939) (emphasis added); accord, *Albert W. Priest Trust*, 6 T. C. 221, 226 (1946). Thus we conclude that the Senate Finance Committee did not use the term "active inconsistency" in the pejorative sense that taxpayers seek to ascribe to it.[4] In fine, we are not persuaded that anything in the legislative history compels us to engraft upon the statute an additional criterion regarding the relative fault of the parties, such as that suggested by the taxpayers, which would detract from its remedial effectiveness. See *United States* v. *Rachal*, 312 F. 2d 376, 383 (5th Cir. 1962); Mullock, The Inconsistent Position, Section 1311(b)(1), 12 Mercer L. Rev. 300, 307 (1961).

Nor do we accept taxpayers' contention that the mitigation provisions were not meant to apply in circumstances like the present because the Commissioner had an opportunity (upon learning that a refund claim had been filed on behalf of the estate of Gus Drechsler) to protect the position of the government prior to the running of the statute of limitations. As the Tax Court said in its opinion in the present case:

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[4]The authority of the Senate Finance Committee Report may be thought of as somewhat impaired by the fact that the predecessor to section 1311(b)(1) was not added to the statute until the conference committee. H. R. Rep. No. 2330, 75th Cong. 3d Sess. (1938), 1939-1 (Part 2) Cum. Bull. 817, 836-37 (1939) (report of House managers on conference).

> "While the mitigation provisions might have been formulated in terms of the Commissioner's or the taxpayer's ability to correct the error when the inconsistency involved was first brought to his attention, they were not so written. Instead, all that the provisions of sections 1311-1314 require is that correction of the error is prevented by the operation of any law or rule of law when the *determination* becomes final (Sections 1311(a) and 1313(a)(1)) and that the notice of deficiency or claim for refund making the correcting adjustment be sent within one year after such determination becomes final (Section 1314(b)). These conditions were met in the present cases."

39 T. C. at 183-184. (Emphasis in original.)

The second provision upon which taxpayers rely is section 1311(b)(3):

> "(3) Existence of relationship.—In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312(3)(B)), the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court of the United States for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination."

Taxpayers contend that the inconsistent position referred to in section 1311(b)(3) was first maintained in 1949 when the refund claim was filed and when the requisite relationship no longer existed. But the legal position adopted by the determination was maintained both in Gus's original returns for 1944 and 1945, at which time taxpayers were

partners,[5] and in the claim for a refund, which was filed after the partnership was terminated. The Commissioner argues, and the Tax Court held, that the inconsistent position referred to in Section 1311(b)(3) was first maintained when Gus's returns for 1944 and 1945 were filed.

Taxpayers point out that when the tax returns for 1944 and 1945 were filed there was no inconsistency between Gus's returns and the returns of the trusts and Lena in the treatment of the partnership income. The inconsistency did not arise, they say, until the partnership income originally reported by the trusts and Lena had been excluded from their gross income by the overassessments and the estate thereafter filed the claim for a refund. Thus, the argument concludes, Gus did not maintain an *inconsistent* position until the estate filed the refund claim.

After the decision of the Tax Court in the present case, the interpretation advanced by taxpayers was adopted by the Ninth Circuit in *Commissioner* v. *Estate of Weinreich*, 316 F. 2d 97 (9th Cir. 1963), which involved a fact pattern substantially identical to that now before us. The analysis of the Ninth Circuit was essentially that the Senate Finance Committee's statement, quoted above, regarding the necessity of "active inconsistency" was to be read into section 1311(b)(3), i.e. the parties must have been related when the taxpayer first maintained an *actively* inconsistent position.

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[5]The parties have stipulated that the T. F. Jackson Company partnership "terminated its business and existence on August 31, 1945, but thereafter such actions were taken as were necessary to wind up its affairs and make final distribution of its assets." From this taxpayers argue that the partnership relationship had terminated prior to the filing of Gus's return for 1945. The Tax Court held that the partnership was only *dissolved* on August 31, 1945, and was not *terminated* until July 21, 1947, when the final distribution of partnership assets was made. That determination is not clearly erroneous. See Treas. Reg. § 1.708-1(b)(1)(i); 6 Mertens, Federal Income Taxation § 35.71 (Zimet ed. 1957).

We have given above our reasons for rejecting the view that the application of the statute requires a showing of "active inconsistency" in the sense in which the taxpayer would have us interpret this phrase. The same reasons lead us to reject the authority of the *Wcinrcich* case.

The Commissioner argues in effect that taxpayers' stress on the word "inconsistent" is misplaced and that the phrase "inconsistent position" in section 1311(b)(3) is simply a short-hand reference to the position successfully maintained by the taxpayer, which, as prescribed by section 1311(b)(1), must be inconsistent with the erroneous exclusion. That is, section 1311(b)(3) requires only that the taxpayers be related when the successful position is first maintained, not when the inconsistency first occurs. See Plumb, The Problem of Related Taxpayers: A Procedural Study, 66 Harv. L. Rev. 225, 255-56 (1952); *Ross* v. *United States*, 148 F. Supp. 330 (D. Mass. 1957).

We hold that the Tax Court was correct in sustaining the Commissioner's position, for this is the most natural reading of the language of the statute and best accords with the manifest purpose of section 1311(b)(3) to ensure that the related taxpayer has notice of the principal taxpayer's ultimate position during the period of the existence of the relationship.

From the foregoing analysis it follows that we uphold the Tax Court's conclusion that the taxpayers are liable for additional taxes under Sections 1311-1314.

## II.

Petitioner Elaine Yagoda contests the propriety of the Tax Court's ruling that as transferee of the Elaine Trust she was liable for taxes due from the trust to the extent of the assets she received upon the trust's termination. The Elaine Trust was terminated on November 12, 1958.

after the determination of the district court upholding Gus's refund claim but prior to the deficiency notices that precipitated this litigation. Elaine acknowledges that a transferee is accountable for any accrued liability of the transferor, even though the amount owing may be determined subsequent to the transfer. See *Meister* v. *Commissioner*, 302 F. 2d 54 (2d Cir. 1962); 9 Mertens, Federal Income Taxation § 53.37 (Zimet ed. 1958). She contends, however, that a different rule applies here because the expiration of the limitations period extinguished the trust's tax liability, *Diamond Gardner Corp.*, 38 T. C. 875 (1962) (alternative holding), and such liability was not revived until the Commissioner issued the statutory notice of deficiency. The Tax Court properly rejected this sophistic argument. At the time of the distribution of the trust's assets Elaine was chargeable with knowledge of the district court's determination and the consequent possibility that a deficiency would be levied against the trust. More appropriate circumstances for the application of transferee liability could scarcely be imagined.

We affirm the determination of the Tax Court.